

Introduction

The Economic Recovery Tax Act of 1981 (ERTA) contained some of the most sweeping tax changes since the adoption of the individual income tax in 1913. The largest tax reduction in history cut individual and corporate taxes by almost \$750 billion over a six-year period. Despite this progress in reducing rates, the relief was slight for most individuals as the personal income tax still remains steeply progressive and the maximum marginal tax rate takes a hefty 50% bite out of earnings, savings, and investment. While ERTA initiated the current debate on comprehensive tax reform, the growing Federal deficit has escalated it. No longer is simplicity the only goal of reform proposals. With more and more frequency, the potential for broadening the tax base and increasing Federal tax revenues has crept into reform considerations.

The Treasury Department has been commissioned to complete a report by year-end 1984 on tax alternatives to individual and corporate income taxes. These alternatives include: a simplified tax based on total income, a consumption tax, broadening the base and lowering rates of the current income tax, a national sales tax, and a value-added tax. Of particular popularity has been the concept of a flat rate income tax. However, just as the greatest appeal of the flat rate tax lies in its simplicity, its greatest coup would be in actually being enacted in that form. This issue of Trends will review the current debate on the flat rate tax and its implications for savings and investment.

We do not necessarily believe that Congress and the Administration will substitute a flat rate income tax for our present income tax structure in the near future. Indeed, if we had to bet, we would guess that our Washington representatives will add a consumption-based tax in 1985 or 1986 to reduce the yawning Federal deficits. Nevertheless, the flat rate income tax concept will receive a full hearing over the next year. It is healthy for the capital markets and securities industry to start thinking sooner rather than later about the implications of such an income tax.

The views expressed in this paper are those of the author and do not necessarily reflect the views of SIA.

The Need for Tax Reform

Bracket Creep & Inflation

The primary purpose of the Federal individual income tax is, of course, to raise revenues for the government. To that end, individual income tax receipts, including social security payments, make up slightly more than half of tax collections. However, the income tax system was not designed for an inflationary environment. A progressive system coupled with an environment of rising prices results in taxes expanding as a percentage of income, the climb of marginal tax rates, and a redistribution of tax burdens.^{1/} Simply stated, in recent years the increases in tax liability for most individuals has been proportionately greater than the increases in their income. This translates into a decline in real after-tax purchasing power as both the progressive income tax and inflation erode increases in income. Bracket creep, the common term for inflation pushing individuals into higher income brackets, was the main impetus behind the start of the flat rate tax movement. While inflation has subsided from the levels that spurred public protest against bracket creep in the 1970s, the growth of two-worker families is but one indication that bracket creep is not necessarily a thing of the past.

Table I shows the phenomena of bracket creep in recent years as well as the Administration's estimates of the effect of ERTA on rates in 1984. Economic growth and the exacerbating effects of inflation contributed to increasing the progressive structure of the tax system. For families with twice the median income, marginal rates escalated from 22% in 1965 to 36% in 1978 and an estimated 43% in 1981 (ERTA not reflected). There were past attempts by policymakers to stem this growing progressivity. However, policymakers are tempted to lower taxes either in equal per capita amounts or in proportion to income. Increased taxes in a progressive tax system combined with tax cuts not in proportion to taxes paid leads to a more progressive system.^{2/} ERTA represented a significant change from this earlier trend.

^{1/} "Recent Trends in the Federal Taxation of Individual Income", Quarterly Review, Federal Reserve Bank of New York, Autumn 1980.

^{2/} Tax Alternatives for America, Hudson Institute, March 1982.

TABLE I
AVERAGE AND MARGINAL INDIVIDUAL INCOME TAX
RATES ON MEDIAN INCOME

Year	Median Income	2X Median Income	5X Median Income	10X Median Income
Average Rates				
1965	7.4	12.2	20.5	36.5
1978	11.6	17.3	30.9	41.0
1981	13.3	18.5	31.7	40.6
1984	11.9	16.0	26.1	32.2
Marginal Rates				
1965	17.0	22.0	39.0	55.0
1978	22.0	36.0	55.0	66.0
1981	24.0	43.0	59.0	68.0
1984	22.0	33.0	45.0	50.0

Source: Congressional Budget Office

Note: Computed for families of four with typical standard or itemized deductions for the particular income level in the particular year; median income for tax-filing families: 1965, \$7,500; 1978, \$18,500; 1981, \$23,700; 1984, \$28,000. The 50 percent maximum rate on income from labor is assumed not to apply. The 1981 tax rates do not include the influence of ERTA.

Effects of Marginal Rates

The steep progressivity and escalating marginal rates in our tax system are taken into account by most individuals in making economic decisions. There are three distinct concerns with high marginal rates: 1. the effect on individuals' incentive to consume in current rather than future periods; 2. the effect on

aggregate savings, investment and productivity; and 3. the composition of savings as a result of the incentive to invest in lightly taxed activities.^{3/} Overall, our tax system has spawned a major disincentive to work harder, take risks, or save and invest, while providing incentives to consume or shelter income.

To stimulate development in various fields, such as energy resources, the tax code provides certain incentives. However, in some cases, unscrupulous promoters have devised abusive schemes which attract thousands of individuals every year. When individuals fall prey to illegitimate tax shelters, funds flow to below market-rate investments and inefficient projects. In 1982, criminal prosecutions were recommended against over 81 promoters of abusive tax shelter plans involving more than 13,000 investors and an estimated tax recovery of \$2.6 billion. In addition, some investors time the realization of gains to coincide with periods when they are in low marginal brackets. The distortions created by high marginal rates stifles the efficient allocation of resources, a process critical to the functioning of our capital markets.

Complexity of the Tax Code

Over the years, the income tax system has become a tool not only for raising government revenues but for fostering certain activities deemed socially desirable by policymakers. The tax code consequently has been built up to a byzantine structure of exemptions, exclusions, credits and deductions. Not that the byzantine nature of the tax code has gone unnoticed. There have been several attempts at reform legislation. However, given a patchwork rather than comprehensive approach, reform legislation has served to exacerbate rather than relieve the complexity of the code. An offshoot to the growing complication of the tax code has been growing taxpayer frustration and increased questioning of the fairness of the tax burden. The complexity of the tax code shares almost equal billing with bracket creep as prime movers of the flat rate tax movement.

There is no doubt that some portion of noncompliance stems from the taxpayer's lack of information or confusion over tax laws. Indeed, a few years ago the IRS tested its agents on their knowledge of tax laws and reportedly 80% failed. Nevertheless, whether by taxpayer ignorance or design, IRS estimates indicate that tax evasion is costing Treasury as much as \$97 billion in tax revenues a year. Moreover, the tax system

^{3/} Analysis of Proposals Relating to Broadening the Base and Lowering the Rates of the Income Tax, Joint Committee on Taxation, 9/24/82.

is such that an estimated 40% of all taxpayers seek professional help in preparing returns, with tax counseling a booming \$60 billion a year industry. In sum, citizens who pay their rightful share believe the current system unfair and confiscatory; those who don't find it full of loopholes; and many find it impossible to figure without the aid of accountants and lawyers.^{4/}

Administrative Cost

The Commerce Clearing House version of the U.S. tax code, with accompanying regulations, totals over 10,000 pages. Moreover, the IRS hopes to issue 140 tax regulations in 1984 in an effort to reduce its backlog of 392 pending tax regulation projects. These massive regulations entail costs in time and money for the government and the taxpayer. IRS employs about 89,000 individuals, and the Administration budgeted \$3.5 billion for the IRS in 1985. The number of specialists trained to interpret the code in the private sector and those trained to administer it in government constitute a "people" resource drain on the economy. In lieu of contributing to the economy in a productive manner, these specialists, depending on whose side they are on, spend their time developing methods to maximize or minimize the impact of the current code.^{5/}

The Flat Rate Tax

In pure theory, a flat rate tax would impose one tax rate across-the-board on all income regardless of source, thus flattening out the progressive structure of our current system and eliminating all credits, deductions, etc. The obvious trade-off to any flat rate proposal is a substantial broadening of the tax base. Given mounting concern over projected Federal budget deficits, the base broadening potential of the flat rate tax has taken on new significance. Put succinctly: It's not the simplicity that will appeal to politicians, but the fact that the flat tax can be used as a means of raising taxes, while seeming to cut them.^{6/} These pending bills propose rates generally ranging up to 30% depending on the definition of taxable income and additional surtaxes in some cases.

^{4/} "Rating the Flat Rate Tax", The Wall Street Journal, 6/30/82.

^{5/} "An Overview of the Issues Concerning a Flat Rate Income Tax", Tax Notes, 6/21/82.

^{6/} "Trojan Horse?", Forbes, 3/14/83.

Any comprehensive tax reform would have to be designed to raise the same amount of revenues as under current law, if not more. In a flat rate system, the broader the tax base, the lower the rate. It is this caveat to the flat rate tax, the broadening of the tax base, that has drawn the most criticism. Senator Russell Long maintains that in response to questions of tax equity, the average voter replies, "Don't tax me, don't tax thee, tax the man behind the tree." Obviously, a pure flat rate tax with an all-inclusive tax base could have the "undesirable" effect of shifting the tax burden to lower income classes. However, most current flat tax proposals via exemptions or widening of tax brackets contain provisions to protect the poor and mitigate the tax burden on the middle classes. For example, the Bradley-Gephardt plan imposes a 14% flat rate and marginal rates of up to 30%, with wealthy individuals paying higher taxes because of the elimination of favorable tax treatment of investment income. There is almost universal agreement that the main stumbling block to comprehensive tax reform would be the dismantling of the current network of credits, deductions, exclusions and exemptions. In addition, opponents of the flat rate tax fear that progressivity would be eliminated.

"Sacred Cows"

In reply to a congressman's query as to what constitutes a "sacred cow", Joseph Pechman, Director of Economic Studies at the Brookings Institute, said "A sacred cow is a tax expenditure which, if you voted to eliminate it, you would lose the next election." With the increase in marginal rates over time came a flurry by legislators of special exemptions to lighten individuals' tax burden. A host of "sacred cows" have ensued as a consequence, with substantial narrowing of the tax base as the end result. Table II shows estimates of revenue losses in 1983 and 1984 from select "tax expenditures" affecting individuals. The full list of individual expenditure items has been gauged at a third of the size of the Federal budget.

TABLE II

SELECTED REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES
(fiscal years, \$ millions)

	Individuals	
	1983	1984
Dividend exclusion	\$ 465	\$ 455
Exclusion of interest on life insurance savings	4,335	4,720
Deductibility of interest on consumer credit	9,215	10,040
Deductibility of mortgage interest/property tax ¹	28,810	31,760
Capital gains ²	15,335	14,660
Deductibility of charitable contributions ³	9,275	9,635
Net exclusion of pension contributions & earnings:		
Employer plans	46,585	50,535
IRAs	8,855	9,190
Keoghs	1,460	1,530
Total (All expenditures)	\$228,376	\$244,626

Source: Tax Notes, 2/6/84

¹ Owner-occupied homes

² Other than agriculture, timber, iron ore and coal

³ Other than education and health

A thorough examination of tax preference items is an essential first step in taking comprehensive tax reform proposals as well as the flat rate tax seriously. Just how much artillery would special interest groups bring to bear on such an undertaking. Table III shows percentage distribution of several tax expenditure items. The removal of the deductibility of mortgage interest and of employer contributions to pension plans would clearly hit the \$30-\$50,000 income bracket the hardest.

A flat rate tax would by no means be an unqualified windfall as there would be repercussions affecting every segment of society. Removal of the tax benefits of owning a house would seriously impact the housing area. The elimination of the tax exemption accorded municipal bond interest would mean higher borrowing costs for cities and states. The removal of the deductibility of charitable contributions might alter

Table III

PERCENTAGE DISTRIBUTION OF SELECTED TAX EXPENDITURES FOR INDIVIDUALS
Based on Tax Return Data
(1982 Law, 1981 Levels)

AGI (\$000)	Mortgage Interest & Property Tax on Owner- Occupied Homes	Net Exclusion of Pension Contributions & Earnings ^{1/}	Capital Gains Excluding Home Sales ^{2/}	Exclusion of Social Security & Railroad Retirement Benefits ^{3/}	Exclusion of Interest on State & Local Bonds ^{4/}	Dividend & Interest Exclusion
0-10	1%	4%	3%	41%	*	5%
10-20	6	13	5	25	*	11
20-30	18	23	9	15	1%	17
30-50	42	34	19	11	5	34
50-100	25	18	24	6	44	25
100+	8	8	40	2	50	8
Total	100%	100%	100%	100%	100%	100%

Source: Office of the Secretary of Treasury, Office of Tax Analysis, 9/23/82.

Note: Details may not add to totals due to rounding; * = less than 1%.

^{1/} Includes the exclusion of contributions and earnings for employer plans and plans for self-employed and others.

^{2/} Includes capital gains treatment of coal royalties, iron ore, certain timber and agricultural income, and other income.

^{3/} Includes the exclusion of disability insurance benefits, OASI benefits and survivors, and railroad system benefits.

^{4/} Includes the exclusion of interest on pollution control bonds, industrial development bonds, housing bonds for owner-occupied homes and rental housing, student loan bonds, hospital bonds, and general purpose state and local debt.

individuals' generosity, thereby putting pressure on eleemosynary activities. A certain amount of Congressional grandfathering would be inevitable if any proposal resembling a flat rate tax were to be implemented. However, phase-in provisions would have to be kept to a minimum because the very success of a flat rate tax hinges on as broad a tax base as possible.

An overnight enactment of a flat rate tax would play havoc with after-tax income, wealth and cash flow. Long-range investment decisions as well as spending patterns have been based on the current tax system. The value of investments such as municipal securities would decline dramatically. On the other hand, there would be no more need for tax shelters, abusive or legal. Spending patterns and levels would undergo significant transformations with the removal of the deduction of consumer interest. Moreover, the adjustment in after-tax wage income itself would precipitate a change in spending patterns. There are a host of transitional considerations, who would benefit and who would lose would depend on the final form of the new tax law. The winners and losers in a change to a flat rate tax concept is a subject requiring a paper by itself.

Progressivity

The degree of progressivity to be incorporated in a tax system is a subjective judgement. Simply defined, progressivity means that taxpayers with higher incomes pay a greater proportion of their income in taxes. There is much mixed emotions on whether this is a valid principle on which to build a tax system. In a Harris poll, individuals were asked if they felt this principle was "fair and equitable" -- 58% agreed it was fair; 38% did not.^{7/} On the other hand, a number of tax experts and laymen contend that the concept of declining marginal utility of income is much too subjective and arbitrary to serve as the basis for the tax structure.^{8/} Vertical equity refers to the tax incidence across income classes and, in our progressive system, is based on the ability to pay. The concept of progressivity, in turn, stems from the marginal utility of income theory -- a dollar of income is considered of more value to a lower income individual than to a higher income individual. That is, a lower income individual must spend his income on necessities, whereas an upper income individual can spend additional income on non-necessities. Depending on the analysis reviewed and the approach taken, our system has been classified as slightly to highly progressive.

^{7/} "The Flatter Tax Movement Picks Up Steam," Fortune, 7/16/82.

^{8/} Tax Notes, 6/21/82.

TABLE IV
FLAT RATE TAX AND PROGRESSIVITY

<u>Income</u>	<u>Taxable Income</u>	<u>Tax</u>	<u>Rate</u>
\$10,000	\$ 5,000	\$ 750	7.5%
\$20,000	\$15,000	\$ 2,250	11.3%
\$50,000	\$45,000	\$ 6,750	13.5%
\$80,000	\$75,000	\$11,250	14.1%

Note: Assumes 15% flat tax and \$5,000 exemption.

Whatever one's stand on progressivity, claims that any flat rate system would eliminate it are false. With the appropriate use of income exemptions, a flat rate tax can be made quite progressive.^{9/} Simplicity and progressivity need not be mutually exclusive in a flat rate system. Table IV, which assumes a 15% flat tax rate with a \$5,000 exemption, is an elementary example of progressivity incorporated in a flat rate tax system.

Future Concerns

Initial considerations aside, should Congress and the Administration manage to hammer out a flat rate tax system, whither future revenue increases? Any proposed flat tax rate assumes a broadening of the tax base by the elimination of tax preference items. Thus, the revenue implications of a 1% point increase in a flat rate tax could be powerful, since even a percentage point increase would raise revenues substantially.^{10/} In addition, given estimates of a necessary phase-in time of ten to 15 years, one must wonder what exemptions, deductions, etc. would find their way back into the tax code before the period would be up.

^{9/} "Can a Flat Rate Tax Work?", Economic Review, Federal Reserve Bank of Atlanta, 9/82.

^{10/} The Flat Rate Tax, Price Waterhouse, 1982.

Savings and Investment and
the Flat Rate Tax

There has been much concern in recent years over the need to stimulate savings and investment in the U.S. There has been just as much concern over the appropriate way to do it. The U.S. economy has been on a relatively slow growth path in recent years. International comparisons of savings and investment offer one explanation for the poor performance of the economy (see Table V). While the 1981 lowering of the maximum tax from 70% to 50% brought U.S. tax treatment of investment income closer to that of other nations, it still remains among the harshest.

TABLE V

SAVINGS AND INVESTMENT AS A PERCENT OF GROSS DOMESTIC PRODUCT
1972-1981

	U.S.	CANADA	JAPAN	FRANCE	W. GER.	U.K.
<u>SAVING</u>						
SAVING AS % OF GDP	6.8	10.6	19.8	11.5	11.6	7.3
SAVING + CONSUMPTION OF FIXED CAPITAL AS % OF GDP ^{1/}	19.1	21.6	33.2	22.6	22.9	18.6
<u>INVESTMENT</u>						
GROSS NON-RESIDENTIAL FIXED CAPITAL FORMATION AS % OF GDP	14.1	17.5	24.8	15.6	15.3	14.9
GROSS FIXED CAPITAL FORMATION AS % OF GDP	18.5	23.0	32.2	22.3	21.8	18.0

Source: Dunn, Mary Lee and Thorning, Margo, "Expenditure Tax Options," American Council for Capital Formation, 3/2/84. Data derived from NATIONAL ACCOUNTS, 1964-1981, Vol. II, Organization for Economic Co-Operation and Development, Paris, 1983.

^{1/} SAVING + CONSUMPTION OF FIXED CAPITAL is the equivalent of saving plus depreciation charges.

The goal of ERTA was to promote economic growth by providing incentives for savings, investment, and work effort. Whether ERTA accomplished its goals is still a matter for debate, although we believe the case for its success in promoting economic recovery is becoming stronger every day. The initial repercussion of ERTA plus adverse economic conditions led to the enactment of TEFRA, which was specifically designed to offset some of the tax reductions of ERTA. Nevertheless, according to simulations produced by Data Resources Inc., ERTA had a strong impact on consumption and an even stronger impact on savings. The 1981 and 1982 effect on savings is estimated at \$12.2 billion and \$31.1 billion, respectively, with the net effect over 1983 - 1985 of both ERTA and TEFRA projected at \$58.3 billion, \$72.3 billion and \$80 billion, respectively.^{11/}

Thus, along with countless other objectives, the fostering of savings and investment has been incorporated as a goal of tax policy. Indeed, the DRI simulations and the experience with the 1978 capital gains tax cut indicate that individuals are very responsive to after-tax returns on investment. During the two years following the 1978 capital gains tax cut, the stock market indices chalked up impressive gains, particularly those indices representing the smaller capitalized companies traditionally chosen by the individual investor. The increased value placed on the stocks of smaller companies subsequently created a market climate conducive to the initial public offerings of new and emerging companies, which create a disproportionate share of new jobs. Venture capital figures soared, as did shareownership. What is particularly most appealing given current Federal budget problems, capital gains revenues in 1979, 1980, and 1981 exceeded those projected by Treasury before the substantial lowering of tax rates on capital gains in the 1978 Revenue Act.

Some of the current comprehensive tax proposals deal specifically with returns on savings and investment, others do not. The double taxation of corporate-source income is to be prevented in one proposal by a set of specifically designed rules. Some proposals exclude dividends and interest from taxation, others exclude capital gains. By and large, most proposals repeal the 60% exclusion for long-term capital gains. For those concerned with savings and investment, the chief objection to flat rate proposals is the failure to address capital gains and interest and dividend income.

^{11/} "Taxes, Saving and Investment: Some Empirical Evidence," National Tax Journal, 9/83.

Authors Galper and Steuerle establish three criteria for savings and investment incentives: avoidance of unnecessary and inefficient asset shifts, provisions of incentives at the margin, and a prevention of tax arbitrage through borrowing.^{12/} While not suggesting that tax incentives necessarily stimulate higher savings rates or that increased savings should be the only goal of tax reform, the authors conclude that none of the existing savings incentives in the tax code meet each of their criteria. Among the tax reform options explored that fulfill the efficient saving incentive criteria is the broader-base, lower-rate tax structure. In terms of savings incentives, the objection that base broadening might increase taxes on individuals with a high propensity to save is discounted on grounds that any proposal can be designed to insure that the taxation of capital income is not increased. Galper and Steuerle conclude that: Although the magnitude of potential tax rate cuts would depend on the degree of base-broadening, even modest efforts toward a broader base could represent an improvement over current savings incentives."

On the other hand, there are proponents of a more comprehensive system who believe that specific incentives for savings should be preserved. Author Calkins, who recommends the return to a tax system designed to raise revenues, advocates that a reduced tax rate applicable to capital gains is one which should be retained -- for many reasons.^{13/} These reasons include: the "lock in effect," which does not contribute to raising revenue nor productive use of assets; simplicity -- to be "tolerably fair" a system which applies ordinary income rates to capital gains must incorporate a system for adjusting basis for inflation; and a "lower rate on gains from risk-taking than on periodic income and income from services probably has desirable economic effects, notwithstanding the encouragement it also provides for some unproductive investment."

The key to stimulating savings and investment via a flat rate tax or any targeted proposal is the tax rate that ultimately applies to returns. Marginal tax rates in 1984 range from 11% to 50%. Therefore, if a flat tax rate of 14% were imposed on taxable income and the various savings and investment tax preferences removed, many taxpayers would still experience a dramatic lowering of marginal rates. With the effective tax rate at 20% on capital gains for individuals

^{12/} "Tax Incentives for Savings, "The Brookings Review, Winter 1983.

^{13/} "A Federal Income Tax Designed For Revenue Only," Tax Notes, 4/9/84.

paying the maximum marginal rate, the treatment of capital gains as ordinary income at flat rates up to 19% would in essence mean a lower capital gains tax rate. Of course, the differential between tax rates on ordinary income and capital gains would disappear. There is a dramatic difference in opinions in evaluating how important the differential is in promoting savings and investment compared to focusing only on the expected after-tax return.

Under some progressive flat-rate type proposals, however, upper income earners could experience higher capital gains taxes. For example, while reducing marginal tax rates from 50% to 30% for upper income earners, the treatment of capital gains as ordinary income under Bradley-Gephardt actually raises the capital gains tax rate by 50%. The "Simple Form" proposal of Senator Mark Hatfield repeals the exclusion for capital gains also, but provides for inflation indexing of the basis price of assets for gains after 1984.

Proposals which sharply increase the effective tax rate on capital gains are disappointing, given the success story of the capital gains tax rate reductions in 1978 and 1981. Most observers believe those rate reductions were successful, ultimately leading to higher rather than lower capital gains tax revenues. In addition, upper income classes paid more in capital gains taxes with lower rates than they did when higher rates were in place. The capital gains tax area appears to be a specific case where "supply-side economics" had an opportunity to work and did so, given sufficient time for the market to respond.

Tax Shelters

Despite the recent lowering of the maximum marginal tax rate, for many taxpayers 50% still represents an unacceptably high rate on marginal earnings. It was basically to prod taxpayers in the upper income groups to invest in developmental-type activities that certain economic incentives were incorporated in the tax code. At times, these provisions of the tax code have been distorted by abusive schemes. This has led to Congressional scrutiny of the entire area of tax shelter investments. Many provisions of TEFRA were aimed at stemming the tide of abusive shelters, and both the Senate and House 1984 tax bills contain proposals to close tax loopholes.

The loss from unproductive investment is two-fold: loss of revenue to the government and loss of funds for capital formation. Under a "pure" flat rate tax, the "building tools" of both productive and unproductive tax shelters would be eliminated. Nevertheless, there will still be a need for individuals to invest in developmental projects, just as there will still be individuals bent on distorting the tax code regardless of tax rates. However, gauging by past experience, the lowering of tax rates on savings and investment has proved efficient and effective in increasing savings in specific vehicles and realizations of capital gains.

TABLE VI
NET LONG-TERM CAPITAL GAINS IN EXCESS OF
NET SHORT-TERM LOSS
(all returns, \$billions)

AGI (\$000)	1977	1978	1979	1980	1981
0-10	\$ 5.8	\$ 5.7	\$ 6.9	\$ 6.8	\$ 8.4
10-20	6.3	6.8	7.0	7.2	5.5
20-30	6.0	6.7	7.6	6.7	6.1
30-50	7.4	8.6	11.0	9.4	9.6
50-100	6.8	7.9	10.7	11.9	13.0
100-200	4.2	5.2	7.6	8.2	9.9
200+	7.4	7.6	19.5	19.7	24.5
Total	\$43.9	\$48.9	\$70.5	\$69.9	\$77.1

Source: Statistics of Income, IRS

Note: Figures may not add to total due to rounding.

Table VI shows a 76% increase in capital gains realizations from 1977 to 1981. The pace of realizations distinctly picked up after the 1978 capital gains tax reduction. Moreover, preliminary figures indicate that realizations increased in 1982 from the 1981 figure. Increased realizations translate to increased Treasury revenues. Treasury obtained capital gains taxes of \$9.3 billion and \$12.4 billion, respectively, in 1978 and 1981.

Savings and Investment Flows

To assume a "pure" flat rate tax would be to treat all investment income, dividends, interest, and capital gains, as ordinary income. One dollar of interest income would be on equal footing with one dollar of earned income, capital gain income, etc. The factors on which savings and consumption decisions are based would undergo radical and dramatic change. Given an absence of deductions, exclusions, and exemptions, many investment vehicles designed around the current tax code to shelter income would be obsolete. The transition period from our current tax code to a flat rate concept would involve major adjustments, as markets seek a new equilibrium based on a new risk-reward investment scale.

While no one can predict what adjustments the transition period might entail, the following scenario is possible. The decision where to place savings and investment funds would be simplified with the elimination of tax preference items. On the other hand, the remaining factors in the savings and investment decision would take on greater importance, such as the degree of risk to be undertaken and the after-tax return. Many short-term instruments, traditional vehicles for savings, would enjoy a tremendous spurt in popularity. The basically riskless nature of bank savings deposits plus the increased after-tax yield would initially attract the majority of increased savings flows.

The counterpart to increased savings flows to short-term money market instruments would be, at least temporarily, depressed prices on other savings and investment vehicles which contain more risk. Corporations would increase pay-out ratios to compete with the greater after-tax yield on competitive instruments. As capital gains and dividends would be taxed at the same rate, investors would place increased emphasis on current rather than future income. The potential appreciation of stocks might be undermined in a shift to a flat rate tax.

Despite the experience of the late 1970s and 1980s, corporate bonds and fixed income instruments have been perceived as low risk investment vehicles, offering both preservation of principal and fixed rates higher than bank investments. Double-digit inflation and government financing needs have pushed returns on corporate bonds to record real levels recently. This volatility has greatly increased the risk of holding fixed income instruments. Thus, to offset the flood of funds to competing investment instruments and depressed prices, returns on fixed instruments would likely climb in quick reaction to a flat rate tax.

The discussion above focuses on shifts in the savings pool among various investment alternatives. If the savings pool were to remain unchanged, there is simply a reallocation of funds to

safer, more liquid investments from riskier vehicles until a new equilibrium is reached. For example, the pre-tax yield on short-term money market instruments would decline while that on equities would increase. However, we do not believe that the total savings pool will remain the same. With marginal rates at 20% or less, there will be a shift away from consumption toward savings. This increases the available funds to all investment and savings vehicles, both short-and long-term. The increased pool of funds may be enough to offset or even exceed those funds which shift toward lower risk investments. In other words, the increased amount of savings and investment resulting from lower marginal rates may be enough to offset those funds shifting toward safer vehicles which are now taxed exactly the same as riskier vehicles.

The expansion of funds flowing into IRA accounts supports the case that lower tax rates foster a trade-off between consumption and investment. According to a study by the Life Insurance Marketing and Research Association, the total "new money" -- that is money from current earnings -- invested in IRAs is estimated at 53% of IRA contributions in 1982 and 56% in 1983. In our view, we cannot stress too strongly that the key to retaining incentives for individuals to invest in risky enterprises hinges on the after-tax rate of return. Whatever the flat rate structure, it is crucial that the top marginal rate or rates remain low enough to encourage risk-taking. No one can quantify the exact rate, but a 20% maximum tax rate on capital gains has proven to be effective in stimulating risk capital. Treating capital gains differently than ordinary income is less important, we believe, than ensuring that the after-tax return is attractive enough to warrant increased savings and investment flows. With the differential between ordinary income and capital gains removed, the tax on capital gains should be on real, rather than nominal, gains.

The foregoing sketch represents a cursory look at market adjustments under a "pure" flat rate tax. There are as many scenarios which could unfold as there are investors in the marketplace. In all likelihood, major tax reform would incorporate more than one tax rate, and these rates would have a significant effect on how securities markets would ultimately settle. To be sure, there would be considerable waxing and waning before markets reached equilibrium.

Conclusion

The pros and cons of a flat rate tax system can be discussed ad infinitum, with elaborate scenarios used to present either side of the case. The basic point is that policymakers can no longer rely on a patchwork approach to raising revenues. The functioning of the current tax system is beginning to deteriorate: tax evasion and the deficit are expanding. The proposed 1984 tax bills contain many provisions aimed at closing tax loopholes created by prior tax laws.

Chances of enacting a pure flat rate tax are obscure. Most proposals built on the flat rate concept have incorporated provisions addressing the main objection to such a tax --an increased tax burden on the lower and middle income classes. Overall, these proposals encompass a dramatic lowering of marginal tax rates. While tax policy is not the sole driving force behind the decision to work harder or save and invest more, lower tax rates would provide greater incentives. Whatever the final outcome of the much heralded tax reform of 1985, the current tax system is obviously in need of serious rethinking. The concept of flat rate taxation deserves a full hearing. The capital markets and securities industry must participate in this debate sooner rather than later.

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SECURITIES INDUSTRY STATISTICS

VOLUME

	APRIL 1984	YEAR-TO-DATE 1984	APRIL 1983	YEAR-TO-DATE 1983	% CHG. Y-T-D 1984-1983
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	85.9	93.1	89.6	86.5	7.6%
AMEX (MILS.)*	5.9	6.2	8.6	8.5	(27.1)
NASDAQ (MILS.)*	57.4	60.3	62.3	59.2	1.9
REGIONAL EXCHANGE (MILS.)*	13.9	14.1	12.9	12.1	16.5
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	56,351	265,354	62,504	244,185	8.7
AMEX (MILS.)	1,664	7,243	2,576	10,022	(27.7)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,900	29,290	8,994	31,483	(7.0)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	13,376	54,751	15,611	62,382	(12.2)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.6	49.3	44.2	43.5	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,793	37,868	5,994	23,264	62.8
AMEX ~~OPTIONS~~	2,644	12,617	2,845	11,770	7.2
COMMODITY	11,652	49,249	8,738	33,696	46.2

* MONTHLY AVERAGE

YIELDS
(MONTHLY AVERAGES)

BOND BUYER INDEX (20 BOND)
CORPORATE BOND YIELDS (MOODY'S)
Aaa CORPORATE
Baa CORPORATE
RATIO Aaa CORPS. TO Baa CORPS.
MUNICIPAL BOND YIELDS (MOODY'S)

	April 1984	April 1983	Basis Point Change	
			April 84	April 83
	9.96	9.0	0.96	
	12.81	11.51	1.30	
	14.31	13.29	1.02	
	0.90	0.87	0.03	
	9.54	8.28	1.26	

PRICES
(END OF MONTH)

DOW JONES INDUSTRIALS
STANDARD & POOR'S 500
NYSE COMPOSITE
AMEX MARKET VALUE INDEX
VALUE LINE COMPOSITE
NASDAQ COMPOSITE

	April 1984	April 1983	% Change
			April 84 - April 83
	1170.75	1226.20	(4.5%)
	160.05	164.42	(2.7)
	91.98	94.27	2.4
	210.40	213.90	(1.6)
	179.91	190.52	(2.6)
	247.44	293.06	(15.6)

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	April 1984	Yr.-to-Date 1984	April 1983	Yr.-to-Date 1983	% Change Y-T-D 1984 - 1983
NET SALES*	2,078.3	7,150.6	2,292.9	6,584.3	8.6%
NET PURCHASE OF COMMON STOCK*	513.9	1,801.1	1,480.8	4,162.8	(56.7)
NET PURCHASE OF OTHER SECURITIES*	749.6	1,776.9	312.4	593.6	199.3
MUTUAL FUND CASH POSITION	12.3	-	10.6	-	-

*EXCLUDES MONEY MARKET, MUNICIPAL
BOND AND OPTION FUNDS

MARGIN DEBT

	April 1984	April 1983	% Change Apr.84 - Apr.83
MARGIN DEBT OUTSTANDING (\$MILS)	22,830	15,260	49.6
NET CHANGE IN MARGIN DEBT (\$MILS)	7,570	3,310	-
% OF ACCOUNTS WITH EQUITY UNDER 40%	12.0	9.0	-

* ALL TIME HIGH

UNDERWRITING
(DOLLARS IN MILLIONS)

CORPORATE FINANCING
(Gross New Issues)

	April 1984	Year-to-Date 1984	April 1983	Year-to-Date 1983	% Change April-April	% Change 1984-1983
Total	6,530	25,527	11,837	39,879	(44.8)	(36.0)
Competitive						
Negotiated						
Common Stock	781	3,355	3,545	13,454	(78.0)	(75.1)
# Of Common Stock Issues	72	294	121	407	(40.5)	(27.8)
Preferred Stock	417	1,617	624	4,385	(33.2)	(63.1)
# Of Preferred Stock Issues	6	26	12	61	(50.0)	(57.4)
Corporate Debt	5,331	20,555	7,667	22,040	(30.5)	(6.7)
# Of Corporate Debt Issues	45	209	83	254	(45.8)	(17.7)
<u>MUNICIPAL FINANCING*</u>						
(Gross New Issues)						
Total	11,097	33,729	15,707	39,922	(29.3)	(15.5)
Notes	6,093	14,231	5,875	12,851	(3.7)	10.7
Bonds	5,005	19,498	9,819	27,058	(49.0)	(27.9)
# of Bond Issues	332	1,222	656	1,580	(49.4)	(22.7)
Negotiated Bonds	3,120	13,313	6,573	18,453	(52.5)	(27.9)
Revenue Bonds	2,946	11,579	5,868	18,661	(49.8)	(37.9)

*Preliminary Figures

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

REVENUE

SECURITIES COMMISSION INCOME
REALIZED AND UNREALIZED GAIN OR
LOSS IN TRADING AND INVESTMENT
PROFIT OR LOSS FROM UNDERWRITING
AND SELLING GROUPS

TOTAL REVENUE

TOTAL EXPENSES

NET INCOME BEFORE TAXES

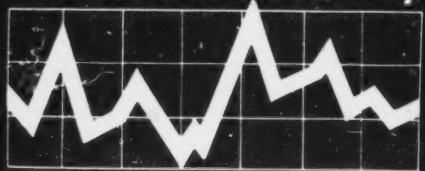
PERCENT OF FIRMS SHOWING LOSS

First Quarter 1984	Yr-to-Date 1984	First Quarter 1983	Yr-to-Date 1983	% Change 1st.Q. 1984 1st.Q. 1983	% Change 1984 - 1983
1,972	1,972	2,112	2,112	(6.6)%	(6.6)%
1,947	1,947	2,178	2,178	(10.6)	(10.6)
553	553	843	843	(34.4)	(34.4)
7,944	7,944	7,189	7,189	10.5	10.5
6,947	6,947	5,896	5,896	17.8	17.8
497	497	1,293	1,293	(61.6)	(61.6)
31.3%	31.3%	10.4	10.4	-	-

RECENT INTERESTING READING AND STATISTICAL MATERIAL

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>SOURCE</u>
Transcript: <u>SIA Trends Conference on Deregulation: Opportunities & Pitfalls</u>	153-page transcript records varied perspectives on how the industry might cope with the inevitable trend toward deregulation. The alternative strategies under deregulation are explored, as well as the specific strategies employed by four different types of firms. In addition, strategies for obtaining capital and distribution are discussed. The keynote speaker, Charles L. Brown, gives an intriguing look at AT&T after divestiture.	SIA Research Department \$25 Conference attendees; \$50 all others
<u>Securities Industry Yearbook 1984-85</u>	Primary reference source on SIA member firms. Hard-cover, 600-page edition contains 5 sections: Firm rankings by capital, Information on publicly-traded firms, Detailed firm data, Geographic listings, and Industry & Market statistics.	SIA Yearbook Dept. \$45 members; \$70 non-members (+ sales tax for NY purchases)
<u>The Investment Banking Process for Primary Equity Securities and the Effects of SEC Rule 415</u>	Doctoral dissertation examining the investment banking process for primary securities issues with regard to SEC Rule 415. Major findings provide food for thought: 1. Rule 415 may not aid issuers if overall costs and benefits are considered, 2. Role of the investment banking firm reduced by Rule 415, and 3. SEC's Rule 415 is flawed.	Gary Gray E.F. Hutton Philadelphia
"Side-by-Side Comparison of the Tax Provisions of the House and Senate Versions of HR4170"	150-page reproduction of pamphlet describing pending tax-increase legislation, prepared for the use of the conferees by the Joint Committee on Taxation. Each item described in terms of present law, House bill and Senate amendment.	Bureau of National Affairs Distribution & Customer Service Center 9439 Key West Avenue Rockville, Md. 20850 \$6

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>SOURCE</u>
<u>Last Half 1983</u> <u>Director of Corporate</u> <u>Financing</u>	Semi-annual directory covers many full year 1983 statistics, with alphabetical listing of and details on issuers and underwriters in second half of the year. Statistical reference section includes: monthly underwriting records, underwriting credits ranking of leading investment bankers, and initial public offerings.	Investment Dealers' Digest 150 Broadway New York, N.Y. 10038 \$125
"Merger-Activity and Leveraged Buyouts: Sound Corporate Restructur- ing or Wall Street Alchemy?"	Report discusses leveraged buyout financing to acquire companies or subsidiaries. These trans- actions involve borrowing most of the purchase price and using the assets of the company or subsidiary acquired as collateral for the loan. Financial and tax aspects of the transactions are discussed, together with issues of risk exposure and fairness to shareholders.	Congressional Resear Service Library of Congress No. 84-643E 5/18/84
<u>NASD 1983 Fact Book</u>	By virtually every measure of performance and growth, the year 1983 was an outstanding one for the NASDAQ market. Data included in report: volume & high-low statistics for each NASDAQ security, and geographic distribution of market makers.	NASD 1735 K Street, N.W. Washington, D.C. 2000
"SIA, Bank Industry Turf Wars Rage On in Court"	Some time, in the coming weeks, the Supreme Court will hand down decisions in two cases that are likely to chart the course for future deregulation of the financial services industry. Article summarizes past SIA bank-broker litigation and determination.	<u>Legal Times</u> 5/28/84



A8825-1

Vol. X No. 4

July 30, 1984

SECURITIES INDUSTRY PERFORMANCE: 1983 AND 1H 1984

HIGHLIGHTS

1. For the securities industry, after-tax ROE declined to 19.8% in 1983 from 22% in 1982. ROE fluctuated widely, ranging from a high of 31.3% in 2Q 1983 to a low of 6% in 4Q 1983.
2. Commission revenues increased substantially in 1983, as equity prices and share volume rose. Underwriting revenues increased by 53%, with revenues from underwriting equity securities rising by 130% because of the surge in IPOs.
3. Industry revenues and expenses were adversely affected by interest rates which began rising in May 1983. Revenues decreased 5% in the 2H 1983 while expenses rose 7%. Interest expense soared 43% in 2H 1983 while so-called fixed expenses increased 12%.
4. The industry continues to become more capital intensive. In 1983, capital climbed 3% or \$3.4 billion. Since 1979, capital has climbed at a very rapid 30% compound annual growth rate.
5. NYSE and NASD discounters' 1983 after-tax ROE was 21.9%. Discounters' market share of retail commissions rose to 9% from 6.3% in 1982, while their estimated share of retail volume rose to 18% from 12.6% in 1982.
6. Though 1Q 1984 after-tax ROE increased to 9% from 6% in 4Q 1983, we estimate industry pre-tax net income fell within a range of -\$50 million to +\$50 million during 2Q 1984. In terms of industry profitability, the 1H 1984 was the worst 6-month period since October 1, 1977-March 31, 1978.

INTRODUCTION

This Trends report is Part I of a two part issue reviewing the securities industry's performance in 1983 and 1Q 1984, including a profitability projection for 2Q 1984. The extensive coverage, analysis and data for the industry necessitates two parts. Part I will examine the aggregate industry's 1983 and 1Q 1984 performance -- revenues, expenses and profitability -- as well as that of discounters and estimates 2Q 1984 profitability. Part II will cover the same ground on a firm category basis (except discounters). Although 1983 industry data and performance are dated by this time, an analysis of the previous full year is helpful for comparisons with prior and future years.

ECONOMIC CONDITIONS

The 1983 economic environment created confusion in the financial markets. Strong economic activity adversely affected the capital markets while slower economic activity seemed to boost security prices. Financial markets were wary of the potential clash between expansionary fiscal policy and monetary policy aimed at preventing a resurgence of inflation. Significant Federal government deficits were projected for fiscal year 1984 and the rest of the decade. Concern was evident over the potential strain in funding triple digit deficits and rapid expansion in the private sector's credit needs.

Economic conditions in early 1983 were favorable for the securities industry. Both monetary and fiscal policies were expansionary but upward pressure on interest rates remained absent because of the weak economy.

The economic recovery picked up momentum in 2Q 1983 as real GNP rose at an impressive annual rate of 9.7 percent. This spurt in expansion resulted from increases in personal consumption and investment. Consumption climbed with a rise in consumer confidence based upon expectations that the recovery would continue, low inflation, relatively stable interest rates and consumers' strong financial position. Investment climbed because of residential construction and a sharp decline in drawing down inventories.

Monetary policy was tightened by the Federal Reserve because of the climb in GNP. Both short-term and long-term interest rates reached their troughs in early May. Concern over strong economic growth, monetary targets and the deficit resulted in rates rising during the rest of the quarter. The securities industry continued to prosper in 2Q 1983 as stock market and

underwriting activity both increased while interest costs rose only moderately.

Real GNP expanded at an annual rate of 7.6% in 3Q 1983. Consumption increased moderately as income growth was limited due to adverse weather and labor strikes. Investment accounted for almost three-quarters of real GNP's 3Q 1983 rise. The most important factor in this rise was inventory accumulation which rose for the first time since 4Q 1981.

The tightening in monetary policy stopped in mid-August. Generally, both short-term and long-term interest rates peaked during the first-half of August and then declined. Still, interest rates rose relative to 2Q 1983. Stock prices declined in August but then increased, ending the quarter slightly above the 2Q 1983.

Economic activity continued rising in 4Q 1983 but at a slower pace as real GNP increased 5.0%. Again, consumers were mainly responsible for this growth although nonresidential fixed investment also rose. Inventory accumulation continued because of the low inventory-to-sales ratio.

Monetary policy eased somewhat in 4Q 1983. M1 and M2 remained in the lower portion of their target bands. Interest rates were relatively stable until December. Favorable economic news and large Treasury borrowings caused rates to rise. Security prices declined over fears that monetary policy would tighten and interest rates would rise further. This trend affected industry revenues adversely while sharply increasing interest expense, the largest single expense for the industry.

PROFITABILITY

The securities industry earned an after-tax ROE of nearly 20% in 1983 (Table 1). Since 1979, after-tax ROE has averaged an impressive 21%. On a quarterly basis, after-tax ROE ranged from 6% to 31% last year. During the first-half of 1983, after-tax ROE reached a record 31%, exceeding that of 1980, but profitability plummeted in the last six months to the lowest level during the past five years except for the first-half of 1982. Using the standard deviations of quarterly profits over the 1979-1983 period, volatility in 1983 ranked only behind 1982.

Interestingly, ROE was lowest in the two years when there was the least volatility, 1979 and 1981. In more recent years, industry volatility has become greater rather than smaller. Given the industry's greater reliance on trading profits, the increased volatility of earnings is no great surprise to those trying to "weather the storm" of swings in security prices.

Table 1

Securities Industry After-Tax ROE

<u>Annual</u>		<u>1983 Quarterly</u>		<u>Standard Deviation of</u>	
<u>After-Tax</u>	<u>ROE</u>	<u>After-Tax</u>	<u>ROE</u>	<u>Quarterly</u>	<u>After-Tax ROE</u>
1979	16%	I	30%	1979	2.4
1980	26	II	31	1980	9.0
1981	19	III	15	1981	7.2
1982	22	IV	6	1982	14.6
1983	20			1983	10.6

Industry profitability declined from 22% in 1982 to 20% in 1983 despite pre-tax net income climbing 26% to \$3.8 billion. Essentially, the decrease in ROE occurred because the addition of significant resources did not generate comparative revenue and profitability gains. Key ratio analysis verifies this conclusion (Table 2). ROE is affected by profit margin, asset turnover and leverage. The asset turnover ratio is considered a rough "productivity" measure of assets. The leverage ratio indicates the degree debt is relied upon compared to equity. In 1983, ROE was adversely affected as the asset turnover ratio declined.

Last year, the pre-tax profit margin declined because of both higher debt and the 35% jump in non-interest expenses while proximate non-interest revenues (excluding margin interest and other-related revenues) rose 34%. The pre-tax profit margin was 18% during the first-half of 1983, but dropped to less than 8% during the last six months. During this latter period, proximate interest revenues (including margin interest and other-related revenues) rose 33% while interest expense soared 43%. Non-interest revenues actually fell in the third and fourth quarters by 16.7% and 2.4%, respectively. Non-interest expenses did not decrease in line with the drop in revenues and actually rose 3.4% in the fourth quarter. As a result, net income dropped 62% in the last-half of 1983.

Table 2
Key Ratio Analysis

<u>Ratio Name</u>	<u>Mathematical Ratio</u>	<u>1982</u>	<u>1983</u>
Asset Turnover Ratio	$\frac{\text{Revenues}}{\text{Average Assets}}$	.180	.163
x	x		
Pre-tax Profit Margin	$\frac{\text{Pre-tax Earnings}}{\text{Revenues}}$	13.1%	12.9%
x	x		
Tax Retention Rate	$\frac{\text{Net Income}}{\text{Pre-tax Earnings}}$	54.0%	54.0%
x	x		
Leverage Ratio	$\frac{\text{Average Assets}}{\text{Average Equity}}$	17.2	17.3
=	=		
Net Return on Equity	$\frac{\text{Net Income}}{\text{Average Equity}}$	22.0%	19.8%

Even though the securities industry's after-tax ROE declined in 1983, it still remained among the most profitable industries. According to Business Week, the four most profitable industries were drugs (19.6%), beverage (17.9%), personal care products (16.9%), and automotive (16.7%).^{1/} Banks and bank holding companies' after-tax ROE was 11.6%. Interest by organizations outside the industry in acquiring securities firms is accounted for by the impressive profitability in recent years, although such interest waned with the downturn in profitability beginning in the 3Q 1983.

^{1/} Business Week, March 21, 1984, pp. 20-63.

REVENUES

Commission Revenues

Commission revenues increased to over \$8.3 billion in 1983 from under \$6 billion in 1982, close to a 40% increase (Table 3).

Table 3

Commission Revenues
(millions of dollars)

<u>Commissions</u>	<u>1982</u>	<u>1983</u>	<u>% Change</u>
Listed Equities on Exchanges	\$4,447.9	\$6,129.7	37.8%
Listed Equities Executed OTC	61.1	112.3	83.8
Listed Options	736.2	796.6	8.2
Other	726.2	1,304.1	79.5
Total	\$5,971.8	\$8,342.9	39.7%

Commission revenues vary with volume and equity prices. Securities prices on most national exchanges registered increases in 1983. For example, the average price of shares traded on the NYSE increased from \$29.67 in 1982 to \$35.40 in 1983, a 19% increase. On the regional exchanges, the average price of shares traded increased to \$31.67 in 1983 from \$28.18 in 1982, a 12% increase. Combined share volume on the NYSE, AMEX, and the regional exchanges climbed to over 27 billion shares from 20 billion shares in 1982, a 35% increase. Consequently, the value of shares traded on exchanges increased by 57% to \$904 billion from \$575 billion in 1982. Commissions did not increase as much as the value of shares traded because of increasing order size. For example, on the NYSE, the average size of a trade increased from 1,305 shares to 1,434 shares, nearly 10%. Large block transactions (10,000 shares and more) constituted 9.8 billion shares of the 21.5 billion shares traded on the NYSE in 1983, or 45.6% of share volume, up from 41.0% in 1982.

On a quarterly basis, commission revenues increased from the 1Q to 2Q, and then declined over the last two quarters of the year (Table 4). This pattern reflects the peaking of both trading volume and stock prices in the 2Q 1983.

Table 4

1983 Quarterly Commission Revenues
(millions of dollars)

<u>Commissions</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
Listed Equities on Exchanges	\$1,565.2	\$1,738.0	\$1,438.5	\$1,388.0
Listed Equities Executed OTC	27.7	31.9	29.4	23.3
Listed Options	195.2	219.3	194.5	187.6
Other	322.4	400.9	312.0	268.8
Total	\$2,110.7	\$2,390.1	\$1,974.4	\$1,867.7

Trading Profits

Industry trading profits increased to \$6.8 billion from \$5.9 billion in 1982, a 15.3% increase. However, trading profits from debt securities, the largest source in 1983, remained almost unchanged from 1982 at \$4.4 billion. Profits from trading other instruments, however, increased dramatically. For example, trading profits from market making in OTC securities more than doubled, going from \$654 million to \$1.4 billion, a 111% increase. The trading of options on national exchanges produced profits of \$63.6 million in 1983, up from \$6.7 million in 1982. Trading profits in the "other" category, which includes commodity futures, financial futures, futures on stock indices, etc., increased by 20% to \$981 million from \$818 million in 1982 (Table 5).

Table 5

Trading Profits
(millions of dollars)

	<u>1982</u>	<u>1983</u>	<u>% Change</u>
OTC Market Making	\$ 654.4	\$1,380.9	111.0%
Debt Securities	4,454.3	4,417.8	(0.8)
Options	6.7	63.6	849.3
Other	817.9	981.3	20.0
Total	\$5,935.0	\$6,838.8	15.2%

Trading profits on debt securities consists of two components: interest payments received on debt securities held, and gains (losses) on positions. Trading profits on debt securities declined slightly in 1983 (0.8%) to \$4.41 billion from \$4.45 billion in 1982. Such profits are basically a function of interest rate trends. The trend on Moody's corporate Aaa-rated and Baa-rated bonds indicated the general direction of interest rates in 1982 and 1983. In 1982, interest rates on Moody's Aaa and Baa bonds declined more or less continuously. The average yield each quarter for both types of bonds was lower than that for the previous quarter. From July 1982 to December 1982, the yield on Aaa-rated bonds declined by 278 basis points and on Moody's Baa-rated corporate bonds, 266 points. Aaa-rated corporate bonds declined only slightly more in 1Q 1983, while Baa-rated corporates declined significantly more. From October 1982 to March 1983, Baa-rated corporate bonds declined by over 100 basis points. Both Baa and Aaa corporate bonds continued to decline into 2Q 1983, Aaa bonds only slightly and Baa bonds more significantly. Yields on both types of bonds started to rise toward the middle of 2Q 1983 and continued to rise throughout the remainder of the year.

Underwriting Revenues

Total securities industry underwriting revenues increased dramatically in 1983 to \$3.5 billion from \$2.3 billion in 1982, a 53% increase. Revenues from equity securities underwriting increased 130% to \$754 million from \$327 million in 1982. As a result, equities accounted for 21% of total underwriting revenues, compared to only 14% in 1982. Revenues from the underwriting of non-equity securities increased by 40% to \$2.8 billion in 1983 from under \$2 billion in 1982 (Table 6).

Table 6

Underwriting Revenues (millions of dollars)

	<u>1982</u>	<u>1983</u>	<u>% Change</u>
Equity Securities	\$327.4	\$754.2	130.4%
Non-Equity Securities	1,988.4	2,782.5	39.9
Total	\$2,315.8	\$3,536.7	52.7%

On a quarterly basis, underwriting revenues increased from 1Q 1983 to 2Q 1983 and then declined in the last two quarters. This pattern was followed by underwriting revenues from non-equity

securities, whereas underwriting revenues from equity securities continued to increase through the 3Q 1983 (Table 7).

Table 7

1983 Underwriting Revenues
(millions of dollars)

	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
Equity Securities	\$158.8	\$ 208.5	\$217.7	\$169.2
Non-Equity Securities	691.6	974.5	653.7	643.7
Total	\$849.4	\$1,003.0	\$871.4	\$812.9

The large increase in 1983 equity security underwriting revenue is explained by the surge in common stock offerings, particularly IPOs. Common stock offerings were up from \$16.5 billion (680 issues) to \$39.1 billion (1,633 issues) in 1983, a rise of 137% and 140% in value and number, respectively (Table 8).

Table 8

Underwriting Activity
(billions of dollars)

	<u>1982</u>	<u>1983</u>	<u>% Change</u>
Corporate Bonds*	\$57.2	\$54.6	(4.5)%
Number of Issues	642	643	0.16
Preferred Stock*	5.3	8.7	64.2
Number of Issues	96	132	37.5
Common Stock*	16.5	39.1	137.0
Number of Issues	680	1,633	140.1
Total Corporate*	78.9	102.4	29.8
Number of Issues	1,418	2,408	69.8
IPOs**	1.4	12.6	800.0
Number of Issues	222	888	300.0
Municipal Bonds (short term and long term)***	123.9	123.4	(0.4)
Number of Issues	9,858	9,462	(4.0)

* Source: Investment Dealers' Digest

** Source: Going Public, Howard & Co.

*** Public Securities Association

Initial public offerings alone increased from \$1.4 billion (222 issues) to \$12.6 billion (888 issues) in 1983. Hence, 50% of the increase in equity offerings in 1983 was accounted for by initial public offerings.

In 1982, underwriting revenues grew by 47.2%. The market share of the top ten firms increased from 50.3% in 1981 to 57.8% in 1982. The top twenty-five firms saw their market share increase from 73.5% in 1981 to 80.5% in 1982. In 1983, underwriting revenues rose by 52.7%, and the share of the top ten firms declined from 57.8% in 1982 to 46.2% in 1983. The share of the top twenty-five firms declined to 76% from 80.5% in 1982 (Table 9). Hence, the increase in concentration of underwriting revenues among the top 10 firms in 1982 was at the expense of the smaller firms, with no change in concentration among the top 11-25 firms. In 1983, there was a decline in underwriting revenues concentration among the top 10 firms, with an increased market share among both the top 11-25 and smaller firms. This decline in concentration is attributable to the increase in equity offerings, particularly IPOs, where smaller firms play a larger role in underwriting and distributing securities.

Table 9
Concentration in Underwriting Revenues
(millions of dollars)

	1982		1983	
	\$	%	\$	%
Top 10	\$1,337.7	57.8%	\$1,633.4	46.2%
Top 11-25	527.4	22.8	1,056.3	29.9
Top 25	1,865.1	80.5	2,689.8	76.0
Rest of Industry	450.7	19.5	847.6	24.0
Industry	\$2,315.8	100.0%	\$3,536.7	100.0%

Margin Interest

Margin interest revenues rose 6.3% in 1983 after plunging 30% in 1982. However, net margin interest income, not gross margin interest revenues, is the important variable for profitability. The trend in net margin interest is suggested by available data including NYSE customer margin debit balances, free credit balances, the broker call rate and the estimated rate or rates charged margin customers (Table 10). Other data not available but useful in determining the profitability of margin business are cash debits against which free credits are used and revenues

received by firms on stocks loaned on customer margin accounts. Available data indicate that net margin interest revenue rose significantly in 1983 as customer margin debit balances soared 48% and free credit balances climbed 24%.

Table 10

Indicators of Net Margin Interest Income*
(billions of dollars)

	<u>NYSE Customer Margin Debit Balances</u>	<u>Free Credit Balances</u>	<u>Average Broker Call Rate</u>	<u>Estimated Rate Charged Margin Customer</u>
1981	\$14.20	\$ 9.04	17.85%	19.35%
1982	12.04	11.65	13.43	14.90
1983	17.78	14.41	10.09	11.44

* All data are averages.

Other Income

Other-related revenues to the securities business basically include interest on repos, M&A fees, private placement fees and interest earned on investments. In 1983, other-related revenues increased nearly 12% after climbing 33% in 1982. Interest on repos is believed to be the largest component of this revenue item and probably rose moderately in 1983. The overnight average repo rate dropped from 11.62% to 9.06%, while average reverse repos climbed 35%, from \$42.1 billion in 1982 to \$57.1 billion in 1983.

Additional components of other-related revenues also contributed to the 1983 rise. Fees from both M&A activities as well as private placements exceeded those for 1982. M&A activity, as reported by W.T. Grimm, was \$73.1 billion in 1983, up from \$53.8 billion in 1982. Meanwhile, private placements climbed to \$36.4 billion from \$22.1 billion in 1982. The 1983 level represented a record and reflected the increased volume of mortgage pass through certificates, CDs, and limited partnership interests.

EXPENSES

Trends in three broad categories of industry expenses are reviewed: employment; interest; and "fixed expenses" -- occupancy & equipment costs, communications and electronic data processing (EDP) equipment costs.

Employment Costs

Nearly all reported employment costs consist of registered representatives' compensation and clerical/administrative expenses. RR compensation includes commissions derived from purchase/sale of securities in the primary and secondary markets and on transactions where the firm acts as a market maker. RR compensation increased by 40% to \$5.7 billion from \$4.1 billion in 1982 (Table 11).

Table 11

Employment Expenses (millions of dollars)

	<u>1982</u>	<u>1983</u>	<u>% Change</u>
Registered Rep. Compensation	\$4,105	\$ 5,748	40.0%
Clerical/Admin-istrative	<u>3,694</u>	<u>4,888</u>	<u>32.3</u>
Total	\$7,799	\$10,636	36.4%

Clerical and administrative expenses - the third largest industry expense category in recent years - increased by \$1.2 billion in 1983 (32.3%) to \$4.9 billion. Part of the \$1.2 billion increase in clerical/administrative costs was due to the fact that the industry had an additional 22,100 support personnel at year-end 1983 compared to year-end 1982, or an increase of 20%.

Interest Expense

Industry interest expense is basically a function of three variables: interest rates, leverage, and assets (really liabilities). In 1983, interest expense rose by \$595 million from 1982 levels (Table 12). This occurred even though 1983 interest rates

were considerably below 1982 levels as average industry assets rose by approximately \$50 billion while industry leverage remained fairly constant at about 17.

On a quarterly basis, there were increasingly large changes in industry interest expense which rose by \$89 million, \$304 million and \$368 million, during the 2Q 1983, 3Q 1983 and 4Q 1983, respectively.

Interest rates continued to decline well into the 2Q 1983 but began to rise in May 1983. Industry assets rose by \$14 billion, \$22 billion, and \$24 billion in the 2Q, 3Q and 4Q, respectively. A larger amount of industry assets was financed by debt. Thus, interest expense skyrocketed in the 2H 1983 even as industry gross revenues were declining. During the 3Q, interest expense rose nearly 24% and another 23% during the 4Q.

Table 12

Components of Interest Expense
(billions of dollars)

	<u>Average Liabilities</u>		<u>Interest Expenses</u>	
	<u>Dollars</u>	<u>% Change</u>	<u>Dollars</u>	<u>% Change</u>
<u>Annual</u>				
1982	\$121.1		\$5.46	
1983	170.6	41%	6.05	11%
<u>1983 Quarterly:</u>				
I	\$155.0	6%	\$1.20	(6)%
II	153.0	(1)	1.29	7
III	169.9	11	1.60	24
IV	191.9	13	1.96	23

Fixed Expenses

Fixed expenses are not supposed to vary much with changes in revenues. In the securities industry, expense items usually considered fixed are occupancy and equipment, communications, and EDP equipment costs. In 1983, these fixed expenses increased by 26%, a startling large percentage, although less than the 34% increase in total expenses less interest expense (Table 13). Occupancy and equipment costs climbed nearly 34% as the number of sales offices of NYSE firms doing a public business increased 13.5% to 5,876 while the number of RRs jumped 17%, to 69,960.

EDP equipment costs and communications expense also rose substantially. These large expenditures were driven by technological developments and by firms continuing to gear up to handle larger and larger numbers of transactions. Naturally, as revenue growth slowed down during the 4Q of 1983 and fell during 1H 1984, the upward trend in fixed costs put enormous strain on profit margins.

Table 13
So-Called Fixed Expenses
(millions of dollars)

	<u>Dollars</u>			<u>Percent Change</u>	
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1982</u>	<u>1983</u>
Occupancy & Equipment	\$ 664	\$851	\$1,137	28%	34%
EDP Equipment Costs	218	272	342	25	26
Communications	<u>1,087</u>	<u>1,269</u>	<u>1,537</u>	<u>17</u>	<u>21</u>
Total	\$1,969	2,392	\$3,016	21%	26%
Total Industry Exp.					
Less Interest Exp.	\$11,967	\$14,623	\$19,672	22%	35%

CAPITAL

The diversification of the industry toward principal business along with regulatory changes such as Rule 415 have required firms to become more capital intensive. In 1983, the jump in capital was a record \$3.4 billion, or 32%. Since 1979, capital has climbed at a rapid 30% compound annual growth rate. In addition, average capital per employee increased from \$524,000 in 1979 to nearly \$1.1 million in 1983. Capital per RR rose from \$1.4 million in 1979 to about \$2.6 million in 1983.

Most of the 1983 climb resulted from an increase in retained earnings and additional infusions of capital (Table 14). Almost all of the jump in retained earnings occurred in the first-half of the year when industry profitability was at a record level. However, additional infusions took place in the fourth quarter despite the drop in industry profitability.

Table 14
Capital
(millions of dollars)

	1982	1983			
	4Q	1Q	2Q	3Q	4Q
Ownership Equity					
Retained earning	\$ 3,859	\$ 4,354	\$ 4,933	\$ 5,168	\$ 5,160
Paid-in capital	2,314	2,417	2,463	2,630	3,209
Partnership	2,285	2,494	2,627	2,841	2,895
Other	479	508	530	523	531
Total	8,937	9,773	10,553	11,162	11,795
Subordinated					
Liabilities	1,842	1,876	2,093	2,241	2,503
Grand Total	\$10,779	\$11,649	\$12,646	\$13,403	\$14,298

DISCOUNTERS

In 1982, we began analyzing the performance of discounters because of widespread interest in this segment of the industry. Included in this analysis are discount firms which are members of the NYSE or NASD. Revised discounter data are presented here for 1982 and 1983. We developed our own discounter list in 1983 which was utilized in the November 1983 Trends issue analyzing discounters' 1982 and first-half 1983 performance. Further refinements have been made to this list based upon new survey work.

NYSE and NASD discounters' 1983 after-tax ROE was 21.9%. However, quarterly profitability ranged from 39% for the 1Q 83 to less than 2% in the 4Q 1983 (Table 15). This volatility occurs because of their dependence on commissions from retail accounts. In 1983, NYSE and NASD discounters' commissions totaled \$331 million or 72% of total revenues. The lack of both revenue and customer diversification results in volatility whenever changes occur in retail activity. At the same time, expenses change less than revenues. For example, in the 4Q 1983, revenue dropped 11%

but expenses declined by less than 1%. So-called fixed expenses (communications, occupancy & equipment, and EDP equipment costs) rose almost 18% in 4Q 1983 because of prior commitments made during more prosperous quarters.^{2/}

Table 15

1983 NYSE and NASD Discounters
(millions of dollars)

	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>	<u>Year</u>	<u>Standard Deviations</u>
Revenues	\$107.5	\$125.2	\$119.6	\$106.2	\$458.5	7.2
Expenses	<u>88.8</u>	<u>105.5</u>	<u>105.8</u>	<u>105.0</u>	<u>405.1</u>	<u>6.5</u>
Pre-Tax Net Income	\$ 18.7	\$ 19.7	\$ 13.8	\$ 1.2	\$ 53.4	6.6
After-Tax ROE	39.3%	35.6%	21.5%	1.7%	21.9%	13.2
Pre-Tax Profit Margin	17.4%	15.7%	11.5%	1.1%	11.6%	5.7

NYSE and NASD discounters' market share of retail commissions and retail share volume have been tracked. In 1983, their estimated market share of retail commissions increased to 9% from 6.3% in 1982 (Table 16). Their estimated market share of retail share volume rose to 18% compared to 12.6% in 1982. Discounters' larger 1983 market share resulted from increased promotional activity and recognition resulting from the participation of large deposit-taking institutions and insurance companies. Still, discounters' market share of total industry revenues amounted to little more than 1%.

^{2/} Based only on NYSE discounters' expenses which account for more than 70% of NYSE and NASD discounters' total expenses.

Table 16

NYSE and NASD Discounters' Market Share,
1982 and 1983
(millions of dollars)

	<u>1982</u>	<u>1983</u>
Industry Commissions	\$ 6,956.6	\$ 9,992.0
Estimated Retail Commissions	3,130.5	3,697.0
Discounters' Commissions	198.0	331.1
Discounters' Market Share of Retail Commissions	6.3%	9.0%
Industry Gross Revenues	\$26,865.3	\$34,786.4
Discounters' Gross Revenues	281.5	458.5
Discounters' Market Share of Gross Revenues	1.0%	1.3%

FIRST-HALF 1984

Profitability in the securities industry plummeted in the first-half of 1984. This will be the worst six-month period since October 1, 1977 - March 31, 1978, more than six years ago. During 1Q 1984, pre-tax net income was \$511 million and after-tax ROE about 9%. FOCUS Report data for 2Q 1984 are not yet available but we estimate that industry pre-tax income ranged between -\$50 million to +\$50 million. The last quarterly loss experienced by the industry was 4Q 1978 (\$11 million).

Industry profitability was low in 1Q 1984 although higher than the after-tax ROE of 6% in 4Q 1983. Commission revenue and trading profits were aided in the early part of the quarter by interest rates temporarily declining in the aftermath of completion of the surge in Treasury borrowing during December and evidence of slower economic growth. After this initial decline, interest rates rose during the rest of the quarter.

Industry profitability was adversely affected by underwriting revenues in the 1Q 1984 which plunged 32% to \$553 million, the lowest level since 2Q 1982. Corporate underwriting volume of \$17.6 billion was 8% below the \$18.9 billion in the 4Q 1983. Although bond issues were 65% above the volume in the 4Q 1983, the

equities markets were devastated with the volume of common stock issues plunging 68% and preferreds decreasing 12%. In addition, tax exempt volume decreased 33%, from \$21.7 billion in 4Q 1983 to \$14.5 billion in 1Q 1984.

Table 17
Underwriting
(billions of dollars)

	<u>1Q 1984</u>		<u>2Q 1984</u>	
	<u>Dollars</u>	<u>Issues</u>	<u>Dollars</u>	<u>Issues</u>
Corporate:				
Bonds	\$14.0	157	\$19.8	124
Preferred	1.1	17	1.2	17
Common	2.3	217	3.4	236
	<u>\$17.4</u>	<u>394</u>	<u>\$24.4</u>	<u>377</u>
Tax-Exempt				
Bonds	\$14.5		\$17.5	

Total expenses increased 0.4% in the 1Q 1984 while revenues rose 3%. Interest expense was up nearly 6% to \$2.1 billion while so-called fixed expenses (communications, occupancy & equipment, and EDP equipment costs) soared 19% to \$862 million. Non-recurring charges which amounted to \$93.4 million in 4Q 1983 because of Baldwin United charges dropped to a more normal \$1.5 million level in 1Q 1984.

Commission revenues appear to have decreased in 2Q 1984. Combined NYSE, AMEX and NASDAQ average daily volume fell almost 9% to 149 million shares. Moreover, the average price per share traded on the NYSE declined almost 6% to \$32.78.

Trading profits probably also fell because of the significant rise in interest rates. For example, the average rate on 20-year U.S. Treasury bonds rose to 13% in 2Q 1984 from 12% in 1Q 1984. In addition, rates rose fairly consistently until early June when they declined briefly.

Underwriting revenues in 2Q 1984 may have risen slightly from the already depressed 1Q 1984 level (Table 17). Bond market activity gives the illusory appearance of having picked up in 2Q 1984 but this is misleading because of zero coupon bonds. For example, one zero coupon Fannie Mae issue is reported at \$6 billion but only \$200 million was actually raised. However, there was some improvement in common stock issues and, to a lesser

extent, preferred stock issues. In addition, tax exempt volume rose 20% to \$17.5 billion.

The 2Q 1984 rise in interest rates also adversely affected industry profitability because of upward pressure on interest expense. Interest expense, which was only \$1.3 billion or 16% of total expenses in 2Q 1983, amounted to almost \$2.1 billion or 28% of total expenses in 1Q 1984. Both these figures will be significantly higher in 2Q 1984. Thus, both revenues and expenses deteriorated because of rising interest rates resulting in a projected break-even level in 2Q 1984, give or take \$50 million in either direction.

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SECURITIES INDUSTRY STATISTICS

VOLUME

	MAY 1984	YEAR-TO-DATE 1984	MAY 1983	YEAR-TO-DATE 1983	% CHG. Y-T-D 1984 - 1983
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	88.2	92.1	93.0	87.8	4.9%
AMEX (MILS.)*	5.9	6.2	12.2	9.2	(32.6)
NASDAQ (MILS.)*	58.0	59.8	71.1	61.6	(2.9)
REGIONAL EXCHANGE (MILS.)*	13.9	14.0	13.0	12.3	13.8
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	64,240	329,594	69,448	313,633	5.1
AMEX (MILS.)	1,666	8,909	3,316	13,338	(33.2)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,362	35,652	8,147	39,630	(10.0)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	13,875	68,626	15,146	77,528	(11.5)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.4	49.5	44.1	43.6	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	10,183	59,197	6,782	36,335	62.9
AMEX OPTIONS	2,412	15,029	3,110	14,880	1.0
COMMODITY	15,043	64,292	8,552	42,248	52.2

* MONTHLY AVERAGE

YIELDS
(MONTHLY AVERAGES)

BOND BUYER INDEX (20 BOND)
CORPORATE BOND YIELDS (MOODY'S)
 Aaa CORPORATE
 Baa CORPORATE
RATIO Aaa CORPORATES TO Baa CORPORATES
MUNICIPAL BOND YIELD (MOODY'S)

May 1984	May 1983	Basis Point Change May 84 - May 83
10.5	9.1	1.4
13.28	11.46	1.82
14.74	13.09	1.65
0.90	0.88	0.02
10.49	8.39	2.10

PRICES
(END OF MONTH)

DOW JONES INDUSTRIALS
STANDARD & POOR'S 500
NYSE COMPOSITE
AMEX MARKET VALUE INDEX
VALUE LINE COMPOSITE
NASDAQ COMPOSITE

May 1984	May 1983	% Change May 84 - May 83
1104.85	1199.98	(7.9) %
150.55	162.39	(7.3)
86.71	94.08	(7.8)
198.63	230.36	(13.8)
169.26	198.38	(14.7)
232.82	308.73	(24.6)

UNDERWRITING
(DOLLARS IN MILLIONS)

CORPORATE FINANCING
(Gross New Issues)

	May 1984	Year-to-Date 1984	May 1983	Year-to-Date 1983	% Change May - May	% Change 1984 - 1983
Total	4,879	30,406	11,271	51,150	(56.7)	(40.6)
Common Stock	1,185	4,540	3,504	16,958	(66.2)	(73.2)
# Of Common Stock Issues	70	364	133	540	(47.4)	(32.6)
Preferred Stock	407	2,025	577	4,962	(29.5)	(59.2)
# Of Preferred Stock Issues	4	30	9	70	(55.6)	(57.1)
Corporate Debt	3,286	23,841	7,190	29,230	(54.3)	(18.4)
# Of Corporate Debt Issues	29	238	77	331	(62.3)	(28.1)
<u>MUNICIPAL FINANCING*</u> (Gross New Issues)						
Total	8,682	42,643	10,684	50,606	(18.7)	(15.7)
Notes	2,310	16,605	2,226	15,077	3.8	10.1
Bonds	6,372	26,038	9,083	36,141	(29.8)	(28.0)
# of Bond Issues	430	1,652	815	2,352	(47.2)	(29.8)
Negotiated Bonds	3,798	17,111	4,799	23,999	(20.9)	(28.7)
Revenue Bonds	3,893	15,472	5,165	24,432	(24.6)	(36.7)

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	MAY 1984	Yr.-To-Date 1984	MAY 1983	Yr.-To-Date 1983	% Change Y-T-D 1984-1983
NET SALES*	1106.4	8257.0	1987.6	8571.9	(3.7%)
NET PURCHASE OF COMMON STOCK	171.2	1972.3	1631.9	5794.7	(66.0)
NET PURCHASE OF OTHER SECURITIES	773.2	2550.1	93.8	687.4	271.0
MUTUAL FUND CASH POSITION	12.3	---	10.5	----	-----

*EXCLUDES MONEY MARKET, MUNICIPAL
BOND AND OPTION FUNDS

MARGIN DEBT

	MAY 1984	MAY 1983	% Change May 84 - May 83
MARGIN DEBT OUTSTANDING (\$MILS)	22,360	16,370	36.6%
NET CHANGE IN MARGIN DEBT (\$MILS)	5,990	4,380	---
% OF ACCOUNTS WITH EQUITY UNDER 40%	12	8	---

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	First Quarter 1984	Yr-to-Date 1984	First Quarter 1983	Yr-to-Date 1983	% Change 1st.Q. 1984 1st.Q. 1983	% Change 1984 - 1983
<u>REVENUE</u>						
SECURITIES COMMISSION INCOME	1,972	1,972	2,112	2,112	(6.6)%	(6.6)%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,947	1,947	2,178	2,178	(10.6)	(10.6)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	553	553	843	843	(34.4)	(34.4)
<u>TOTAL REVENUE</u>	7,944	7,944	7,189	7,189	10.5	10.5
<u>TOTAL EXPENSES</u>	6,947	6,947	5,896	5,896	17.8	17.8
<u>NET INCOME BEFORE TAXES</u>	497	497	1,293	1,293	(61.6)	(61.6)
<u>PERCENT OF FIRMS SHOWING LOSS</u>	31.3%	31.3%	10.4	10.4	-	-

RECENT INTERESTING READING AND STATISTICAL MATERIAL

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>SOURCE</u>
<u>SIA's Report on Production and Earnings of RRs in 1983</u>	Annual study presents summary analysis on retail and institutional production, payout, ticket size and earnings as well as trends in these areas over the last ten years. Results are given for the industry as a whole and by firm size category.	Madeleine Ritter SIA \$300 non-participating members \$1,000 non-members
<u>Securities Industry Yearbook 1984-85</u>	Primary reference source on SIA member firms. Hard-cover, 600-page edition contains 5 sections: Firm rankings by capital, Information on publicly-traded firms, Detailed firm data, Geographic listing, and Industry & Market statistics.	SIA Yearbook Dept. \$45 members; \$70 non-members (+ sales tax for NY purchases)
"The Euromoney Five Hundred"	Annual ranking of the world's 500 largest banks by equity. Statistical features include: top 100 by ROE, assets and net income; fastest growing and slowest growing; and leading banks by country.	<u>Euromoney</u> 6/84
"Wall Street puts its own money on the line"	Review of development of merchant banking activities on Wall Street. Rationale for development: with margins in traditional lines of business under increasing competitive pressure, investment bankers see merchant banking as a way of enhancing profitability as well as nourishing and protecting capital.	<u>Institutional Investor</u> 6/84
<u>Mergerstat Review - 1983</u>	A 150-page statistical reference source on merger activity in 1983, with certain historical observations. Five major sections include data on: dollar value paid, medium payment, acquisition leaders, divestitures, and foreign buyers and sellers.	W.T. Grimm & Co. 135 South LaSalle Street Chicago, Ill. 60603

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>SOURCE</u>
<u>Economic Choices 1984</u>	Authors of this book present a detailed plan for reducing the deficit and increasing future flexibility in domestic spending, improving the effectiveness of defense expenditures, and reforming the federal tax system. In addition, new directions in industrial and trade policy, government promotion of R&D, and policies to aide poor and dislocated workers are suggested.	The Brookings Institute 1775 Massachusetts Ave., N.W. Washington, D.C. 20036
<u>The Deficit Dilemma-- Budget Policy in the Reagan Era</u>	Authors Mills and Palmer in five chapters review the changing federal budget deficit under President Reagan from the initial budget plan to the economic-political dilemma now posed by the size of the deficit. Authors conclude that the disparity between projected federal revenue and outlays is so great as to require action on 3 major fronts: tax increases, a scaleback of the defense buildup, and restraint on domestic spending.	The Urban Institute 2100 M Street, N.W. Washington, D.C. 20037
"Upheaval i. Life Insurance"	The inflation and high interest rates of the late 1970s have forced the insurance industry to rethink its basic product. To compete, many insurance companies are also adding mutual funds, limited partnerships and other securities-based investment packages. Article reviews pros and cons of new strategies for insurance industry.	<u>Business Week</u> 6/25/84
"Pound of Flesh, Ounce of Balm"	Somewhat humorous capsule summary of the 1984 Tax Bill, focusing on implications for investment.	<u>Barron's</u> 7/2/84